

DANIELLS PHILLIPS VAUGHAN & BOCK

Review Report

QUALITY CONTROL REVIEW

For the Firm's Audit of
Panama Buena Vista Union School District
for the Fiscal Year Ended June 30, 2002



STEVE WESTLY
California State Controller

January 2004



STEVE WESTLY
California State Controller

January 21, 2004

Ms. Nancy Belton
Daniells Phillips Vaughan & Bock
300 New Stine Road
Bakersfield, CA 93309

Dear Ms. Belton:

The State Controller's Office has completed a quality control review of Daniells Phillips Vaughan & Bock. We reviewed the audit working papers for the firm's audit of Panama Buena Vista Union School District for the fiscal year ended June 30, 2002.

A draft report was issued on October 22, 2003. The firm's response to the draft report is included in this final report.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

A handwritten signature in dark ink, reading "Vincent P. Brown". The signature is fluid and cursive.

VINCENT P. BROWN
Chief Operating Officer

VPB:ams

cc: Douglas J. Miller, Superintendent
Panama-Buena Vista Union School District
Dr. Larry E. Reider, Superintendent
Kern County Office of Education
Arlene Matsuura, Educational Consultant
School Fiscal Services Division
California Department of Education
Charles Pillsbury
School Apportionment Specialist
Department of Finance

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Review Report

Summary

The State Controller's Office (SCO) has completed a quality control review of the audit working papers for an audit performed by Daniells Phillips Vaughan & Bock of the Panama Buena Vista Union School District for the fiscal year (FY) ended June 30, 2002. The last day of fieldwork was June 19, 2003.

The audit referred to above was performed in accordance with the majority of the standards and requirements set forth in *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted governmental auditing standards (GAGAS); generally accepted auditing standards (GAAS); Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO. However, the SCO reviewers noted the firm did not fully comply with GAGAS in regard to audit documentation.

Background

Any governmental unit subject to a single audit must have the audit performed in accordance with the standards referred to in this report. According to OMB Circular A-133, the auditor's work is subject to a quality control review at the discretion of an agency granted cognizant or oversight status by the federal funding agency. In addition, *Education Code* Section 14504.2 authorizes the SCO to perform quality control reviews of working papers for audits of K-12 local educational agencies to determine whether audits are performed in accordance with U.S. General Accounting Office standards for financial and compliance audits.

Daniells Phillips Vaughan & Bock is an independent CPA firm located in Bakersfield, California. The firm has been the independent auditor for the Panama Buena Vista Union School District since FY 1995-96. The audit of Panama Buena Vista Union School District was the only local educational agency audit performed by the firm in FY 2001-02. The district operated 15 elementary schools and 4 junior high schools, with a total average daily attendance (ADA) of approximately 12,600 claimed for the purpose of state funding.

Objectives, Scope, and Methodology

The general objectives of the quality control review were to determine whether this audit was conducted in compliance with:

- GAGAS
- GAAS
- K-12 Audit Guide
- OMB Circular A-133

The quality control review was conducted at the office of Daniells Phillips Vaughan & Bock. The SCO reviewers compared the audit work performed by the firm, as documented in the working papers, with the standards stated in the general objectives.

Conclusion

The audit referred to above was performed in accordance with the majority of the standards and requirements set forth in GAGAS, GAAS, OMB Circular A-133, and the K-12 Audit Guide. However, the SCO reviewers noted the exception discussed in the Finding and Recommendation section of this report.

In conjunction with the review, the SCO also issued a management letter (attached). This letter describes a condition that, while not sufficiently material to include in this report, should be corrected by the firm.

This report is applicable solely to the audit working papers referred to above and is not intended to pertain to any other work of Daniells Phillips Vaughan & Bock.

Views of Responsible Official

The SCO issued a draft report on October 22, 2003. The firm responded by letter dated December 15, 2003, generally disagreeing with the review results. The response is included in this final report as Attachment 2.

Restricted Use

This report is intended solely for the information and use of the specified parties; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.



JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

Finding and Recommendation

General

The Single Audit Act and the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO, require audits to be performed in accordance with generally accepted auditing standards (GAAS). These standards deal with the quality of the audits performed by the independent auditor and have been approved and adopted by the American Institute of Certified Public Accountants (AICPA). GAAS is divided into three areas: (1) general standards; (2) fieldwork standards; and (3) reporting standards. The three areas are divided into ten specific standards. In addition to GAAS, auditors of governmental entities must also perform audits in accordance with generally accepted government auditing standards (GAGAS), which expands the GAAS standards in several areas.

In the course of this quality control review, the SCO reviewers found that the firm did not fully comply with a GAGAS standard.

Noncompliance with Generally Accepted Government Auditing Standards (GAGAS)

FINDING— Insufficient documentation

While reviewing the audit program and working papers for the Panama Buena Vista Unified School District, the SCO reviewers noted several instances where testing was not documented and possibly not performed and working papers were not referenced to supporting documentation. In addition, significant conclusions were made about procedures; however, the working papers did not contain supporting documentation, or testing to support the conclusions. Instances noted are as follows:

General Fund Stores

Inventory valuations, totaling \$712,000 according to the FY 2001-02 audit report, were not tested. No explanation or statement was included in the working papers to justify the immateriality of the stores inventory valuation, or the lack of inventory audit procedures being performed. Although materiality levels were set for governmental type funds (i.e., general fund), tolerable misstatement and individually significant item materiality levels were not documented. No finding was presented and the audit report was unqualified. Subsequent verbal discussions with the audit partner disclosed that the auditee had very strong inventory controls and the auditor had not found any problems with inventory in prior years, thus deeming it unnecessary to perform an inventory observation. The audit partner also stated that the inventory value was below the general fund materiality level. However, the decision and rationale to support the decision were not documented in the working papers.

Firm's Response

We had conducted inventory observations in prior years for this client and found the controls to be very strong, with no adjustments required as a result of the observations. In addition, the dollar amount of the inventory was below our documented materiality threshold. These discussions were held between the senior in-charge of the audit and the audit partner, and it was determined observation was not required. However, a memo to this effect was not put into the file and should have been.

We do believe that materiality and tolerable misstatement are documented in our files. There is a workpaper in the file calculating materiality for each fund type. Tolerable misstatement is defined in the manuals that we use consistently throughout our audit practice, and are referred to in our Quality Control Document. We do not believe that part of the finding to be accurate as written.

SCO's Comment

As noted in the firm's response, the inventory working papers did not include adequate documentation regarding the rationale for not performing a physical inventory observation.

The additional documentation submitted showed that the inventory balance exceeded the firm's materiality limit for testing by \$44,399. Using the additional information submitted, it appears that inventory should have been tested. The statement regarding materiality remains.

In addition, the working papers did not include any indication of, or reference to, the firm's Quality Control Document or tolerable misstatement policies.

The finding remains unchanged.

Instructional Materials

The firm lacked working paper documentation for audit procedure 3, which would support the conclusion that the district complied with the ten-day requirement of sending an advance notice of the public hearing. According to the working papers, the district received approval from the State for the meeting to be conducted late and the meeting was scheduled August 13, 2002, and held August 27. However, it is unclear whether a resolution was actually issued by the board as required.

Firm's Response

Our workpapers contained both a copy of the minutes that referred to the motion carried regarding scheduling the public hearing for the next regular board meeting date, as well as a copy of the minutes from August 27, 2002 documenting that the hearing was in fact held. The only item not in the workpapers was a copy of the actual resolution issued by the board.

SCO's Comment

No documentation was provided to verify that the district had complied with the ten-day requirement of sending an advance notice of the public hearing.

Education Code Section 60119(b) states, "The governing board shall provide 10 days' notice of the public hearing or hearings set forth in subdivision (a). The notice shall contain the time, place, and purpose of the hearing and shall be posted in three public places in the school district."

The firm's response indicates that the second hearing took place, but does not indicate that a resolution was actually passed by the board.

As stated in *Education Code* Section 60119(11) and (2)(A), the governing board is required to either pass a resolution, or if it has been determined that there are not enough textbooks or instructional materials, the governing board shall provide information to classroom teachers and to the public setting forth the reasons for the insufficiency and shall take action to ensure that within two years from the date of the determination that each pupil has enough textbooks or instructional materials.

The finding remains unchanged.

National School Lunch Program

Period of Availability of Federal Funds: Testing for suggested audit procedure 2 was not documented. The procedure suggests that the auditor test a sample of transactions charged to the federal award after the end of the period availability and verify that the underlying obligations occurred within the period of availability and that the liquidation (payment) was made within the allowed time period. According to the working papers, "All info [was] on consolidated application." However, there was no reference as to the location of the consolidated application or to any testing performed. Subsequent verbal discussion with the audit partner disclosed that the consolidated application was not included in the working papers or the permanent file.

Program Income: Suggested audit procedure 1(b) suggests that the auditor inquire of management and review accounting records to ascertain if program income was received. This procedure was "N/A." However, there is no rationale or documentation to support the conclusion of "N/A."

Firm's Response

National School Lunch Program Period of Availability of Federal Funds: The procedures referred to were performed and noted in the audit workpapers. We did not retain a copy of the Consolidated Application in our workpapers, and have not seen any such requirement that this be retained. However, for the June 30, 2003 audit we did retain this document at the suggestion of the State auditors, and will continue to do so.

National School Lunch Program Income: There was no program income

received by this client. The notation of “N/A” on the workpaper was intended to imply that. We agree that it would have been more clear to write “no program income” on the workpaper.

SCO’s Comment

Period of Availability of Federal Funds: Testing for suggested audit procedure 2 was not documented. The working papers stated, “All info on consolidated application.” However, no consolidated application was included in the working papers or the permanent file to document the testing that was performed.

The finding remains unchanged.

Title I

Eligibility: Testing for suggested audit procedure 2 was not documented and possibly not performed. The procedure suggests that the auditor test the information used in determining eligibility and ascertain if the population or area of service delivery was eligible. According to the working papers, “District determines which schools qualify for Title I funds based upon free & reduced lunches.” However, there were no references to, or documentation of, any testing performed to ensure the schools that qualify for Title I funding are in fact the same schools that qualify for free and reduced lunches.

Equipment and Real Property Management: There were no initials or working paper references to identify if the work was performed, by whom, or, if the section was “N/A,” why the section was “N/A.” The columns for all procedures were blank with no explanation.

Period of Availability of Federal Funds: Testing for suggested audit procedure 1 was not documented. The procedure suggests that the auditor review the award documents and regulations pertaining to the program, determine any award-specific requirements related to the period of availability, and document the availability period. The independent auditor stated, “No awards, All on Consolidated Application.” It is difficult for the SCO reviewer to determine if the consolidated application contained the requirements for the program because it was not included in the working papers.

Reporting: Testing for suggested audit procedure 1 was not documented. The procedure suggests the auditor review the applicable laws, regulations, and provisions of the contract or grant agreements pertaining to the program for reporting requirements. According to the independent auditor’s remark, “Consolidated Application,” on the working papers, it is difficult for the SCO reviewer to determine if the consolidated application contained the requirements for the program, as it was not included in the working papers.

GAGAS Section 4.35 states:

Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

OMB Circular A-133 Section .500 requires the auditor to perform the following:

- (d) Compliance. (1) In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. . . .
(4) The compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

The working paper documentation does not support the basis for excluding any inventory audit procedures from the auditor's responsibilities. The audit opinion report could potentially be misstated if procedures for inventory have been excluded and inventory is considered direct and material to the fair presentation of the financial statements.

The firm did not perform auditing procedures and/or provide documentation of testing or rationales to support "N/A" conclusions for OMB Circular A-133 compliance requirements.

The accuracy of the independent auditor's opinions on both federal and state compliance may be impaired when evidential matter gathered is not considered sufficient and competent.

Recommendation

The auditor should document all testing performed. If any procedure is determined to be not applicable, the basis or rationale as to why the procedure was not applicable should be documented as well.

Firm's Response

Title I Eligibility: This testing was performed by use of the Consolidated Application, but again, that document was not retained in our files for that year.

Title I Equipment and Real Property Management: This testwork is typically performed at a different time of year than the other compliance testwork, due to the client staff associated with this program not being available during the summer months, when other work is performed. We believe this is how the oversight occurred of the documentation of this work. However we do believe it was performed and has been performed and documented in the subsequent year.

Title I Period of Availability of Federal Funds and Title I Reporting: Again, the procedures were noted on the workpapers as having been performed using the Consolidated Application, but we did not retain the document in the working papers.

SCO's Comment

Title I Eligibility and Period of Availability of Federal Funds and Title I Reporting: The working papers stated, "All info on consolidated application." However, no consolidated application was included in the working papers or the permanent file to document the testing that was performed.

The finding remains unchanged.

Attachment 1— Management Letter



STEVE WESTLY
California State Controller

January 21, 2004

Ms. Nancy Belton
Daniells Phillips Vaughan & Bock
300 New Stine Road
Bakersfield, CA 93309

Dear Ms. Belton:

During the State Controller's Office (SCO) quality control review of the audit working papers relating to your firm's audit of the Panama Buena Vista Union School District for the fiscal year ended June 30, 2002, we noted a condition that should be brought to your attention.

We are providing this comment to assist the firm in fully complying with the *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted auditing standards (GAGAS); generally accepted auditing standards (GAAS); the requirements of the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO; and the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Because our only intent is to inform you of this observation, you need not respond to the SCO regarding actions planned or taken on this matter. However, we believe the firm should take action to correct this condition.

Our comment is based on circumstances that existed as of June 19, 2003, and does not reflect changes made subsequent to that date. The following comment refers to a condition noted during our review, along with a recommendation for improvement.

Potential Noncompliance with K-12 Audit Guide

The SCO reviewers noted a group of working papers containing notes for the subsequent year's audit. These notes:

- Advised the auditor to stay consistent with school sites selected for testing and to not select different schools as had been done in the past; and
- Instructed the auditor to look into using a different schedule than the normal bell schedules for instructional minute's computations.

Our concern is that if these notes were followed, the results of testing and instructional minute recalculations could be incorrect and not representative of the entire population. For attendance reporting, the sample of schools should be representative of the entire population of schools in order for testing results to be effective. For testing purposes, the K-12 Audit Guide specifically directs the auditor to select a representative sample of school sites. In addition, for instructional time determination, bell schedules are the source documents from school sites and are required to be used pursuant to the K-12 Audit Guide for calculating instructional minutes. These calculations are then verified to the instructional minutes reported by the district in the audit report.

As we discussed on June 19, 2003, these notes may mislead a subsequent auditor to incorrectly or inadequately perform auditing procedures that would give a false sense of compliance to the school district and may lead to an incorrect audit report being issued.

Recommendation

The specific working papers that contain the non-standard procedures for the subsequent year's audit should be removed from the working papers. State and federal procedures should be followed according to published guidelines.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB:ams

RE: S03-LEQ-005

**Attachment 2—
Firm's Response to Draft Management Letter and Report**



Daniells
Phillips
Vaughan
& Bock

Member of the McGladrey Network

Member of AICPA Division for Firms
Private Companies Practice Section
NANCY C. BELTON

December 15, 2003

Steve Westley
California State Controller
P. O. Box 942850
Sacramento, CA 94250-5874

This letter constitutes our official response to the management letter issued in October 2003 by the State Controller's Office.

As we verbally represented to the audit team, we strongly disagree with the comment. The notations that are referred to are not in fact workpapers for the current year under audit, but informal notes written by staff accountants for consideration in the future year. They had not been subjected to review at any level, since the following year's audit had not yet begun. No action had been taken or even considered to make the changes that the management letter suggests.

In questioning the staff accountants who wrote the notes, it was determined that the wording of the memo did not convey the suggestions that were intended. Specifically, the first item meant that the same schools should be used for various tests within the same audit year, but not to stay at the same schools from one year to the next. We have consistently rotated schools from year to year for testing, and will continue to do so. The second item should have said to consider using other information "in addition to" the bell schedules, not "instead of" the bell schedules. The reason for this comment is that in Kern County there are many 2-hour fog delay days during our school year, and without considering that in addition to the bell schedules, one would not come to an accurate result for instructional minutes.

While we agree that these comments lacked clarity and therefore were subject to misinterpretation, we do not believe they were even subject to the review that was conducted, as they were informal memos to be evaluated and resolved in a future year.

Sincerely,

Nancy C. Belton
Certified Public Accountant

NCB/sln:3774

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Member of AICPA Division for Firms
Private Companies Practice Section
NANCY C. BELTON

December 15, 2003

Steve Westley
California State Controller
P. O. Box 942850
Sacramento, CA 94250-5874

This letter constitutes our official response to the report dated October 2003 of the California State Controller's Office. The overall finding is appropriately titled "Insufficient Documentation." We would like to emphasize that we believe all audit procedures required by generally accepted government auditing standards were conducted, however we agree that in certain areas our documentation of those procedures was not as complete as it should have been. Our responses to the individual items under this heading are as follows:

General Fund Stores: We had conducted inventory observations in prior years for this client and found the controls to be very strong, with no adjustments required as a result of the observations. In addition, the dollar amount of the inventory account was below our documented materiality threshold. These discussions were held between the senior in-charge of the audit and the audit partner, and it was determined observation was not required. However, a memo to this effect was not put into the file and should have been.

We do believe that materiality and tolerable misstatement are documented in our files. There is a workpaper in the file calculating materiality for each fund type. Tolerable misstatement is defined in the manuals that we use consistently throughout our audit practice, and are referred to in our Quality Control Document. We do not believe that part of the finding to be accurate as written.

Instructional Materials: Our workpapers contained both a copy of the minutes that referred to the motion carried regarding scheduling the public hearing for the next regular board meeting date, as well as a copy of the minutes From August 27, 2002 documenting that the hearing was in fact held. The only item not in the workpapers was a copy of the actual resolution issued by the Board.

Steve Westley
California State Controller
December 15, 2003
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National School Lunch Program Period of Availability of Federal Funds: The procedures referred to were performed and noted in the audit workpapers. We did not retain a copy of the Consolidated Application in our workpapers, and have not seen any such requirement that this be retained. However, for the June 30, 2003 audit we did retain this document at the suggestion of the State auditors, and will continue to do so.

National School Lunch Program Income: There was no program income received by this client. The notation of "N/A" on the workpaper was intended to imply that. We agree that it would have been more clear to write "no program income" on the workpaper.

Title I Eligibility: This testing was performed by use of the Consolidated Application, but again, that document was not retained in our files for that year.

Title I Equipment and Real Property Management: This testwork is typically performed at a different time of year than the other compliance testwork, due to the client staff associated with this program not being available during the summer months, when other work is performed. We believe this is how the oversight occurred of the documentation of this work. However we do believe it was performed and has been performed and documented in the subsequent year.

Title I Period of Availability of Federal Funds and Title I Reporting: Again, the procedures were noted on the workpapers as having been performed using the Consolidated Application, but we did not retain the document in the working papers.

We completely concur with the recommendation that we should document all testing performed. We believe that the vast majority of testing was properly documented, and that the items noted represent relatively insignificant omissions in isolated cases. We have reviewed the findings with the engagement team for this audit, and will continue to stress throughout our monthly training meetings the importance of documentation.

Sincerely,



Nancy C. Belton
Certified Public Accountant

NCB/sln:3774-2

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250-5874**

<http://www.sco.ca.gov>